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RECENT DEVELOPMENTS IN VALUE ADDED TAX 2018

Series on International Tax Law, Michael Lang (Ed)

Lang/Pistone/Rust/Schuch/Staringer/Pillet (Eds)

CJEU – Recent Developments in Value Added Tax 2018

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Univ.-Prof. Dr. Dr. h.c. Michael Lang (Editor)

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CJEU – Recent Developments in Value Added Tax 2018

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Preface

The Court of Justice of the European Union (CJEU) is a driving force in the field of European Union indirect taxation. As the significance of VAT as a revenue source continues to increase, it is increasingly valuable and important for business practitioners, government representatives, and academics alike to have a forum for the thorough analysis and exchange of opinions on indirect taxation cases pending at the CJEU.

On 29 to 31 January 2019, the Institute for Austrian and International Tax Law of WU (Vienna University of Economics and Business) hosted a Conference: **Court of Justice of the European Union: Recent VAT Case Law**. This conference project began upon the initiative of the Taxation and Customs Union Directorate of the European Commission and was the sixth conference in this series to be held at the Institute. The conference was a resounding success and brought together leading academics, judges, government representatives, and business representatives from all over the world. The cases presented and the issues raised at the conference are published in this book.

We are very grateful to the authors who not only delivered impressive presentations and articles but also committed themselves to an extremely ambitious schedule which allowed for vivid exchanges during the conference. This allowed us to address an extensive number of areas as well as to publish this book. It goes without saying that all opinions expressed in this book can only be attributed to the respective authors themselves and not necessarily to their employees; to the editors involved, their employers or employees; or to any other organization or committee.

We would like to express our sincere gratitude for Linde's cooperation and swift realization of this publication project.

Above all, we would like to thank the members of the Institute for Austrian and International Tax Law and, in particular Renée Pestuka, who was responsible for the organization and preparation of the conference and getting the book published. Likewise, Eleanor Campbell contributed greatly to the completion of the book by editing and polishing texts for the authors, many of whom were writing in English as a foreign language. Furthermore, we are also grateful to Desiree Auer who also helped in organizing the conference and editing this book.

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Part I

EU Fundamental Principles and VAT

Art 17 ECFR on the right to property and VAT

Edoardo Traversa/Stefania Lotito Fedele

1. Introduction: Human rights and taxation in the European Union and ECHR legal order

Although the EU harmonization process in the area of Value-added tax started several decades ago, issues relating to its compatibility with fundamental rights have only arisen relatively recently.[1] As the case law of the European Court of Human Rights shows, human rights may have an impact on the application of VAT domestic rules in many areas, such as administrative penalties and sanctions, criminal proceedings, procurement of evidence, procedural guarantees, VAT fraud and abuse, VAT exemptions, VAT deductions or VAT increases. Despite the fact that the terms "tax", "taxation" or any other concept related to it do not appear in any provision of the European Convention on Human Rights, except in Art. 1 of Protocol No.1[2], many ECHR judgments have been rendered on various issues relating to the application of tax laws: the principle of legality of taxation and legitimate purpose[3], the principle of clarity of standards[4], the principle of unreasonable non-retroactivity of substantive tax rules[5], the principle of proportionality of the tax[6], the principle of non-discrimination[7], the right to silence and non-self-incrimination[8]; and the *ne bis in idem* principle under Art. 4 of Protocol No. 7.[9] Other cases concern the procedural guarantees relating to due process of law and fair trial (reasonable duration, impartiality of the judging body, guarantee regarding the evaluation of the evidence, etc.).

In this context, this chapter will address the question whether VAT taxable persons can rely on the right to property (Art. 17 of the EU Charter in conjunction with Art. 52 of the Charter) in order to safeguard their right to input VAT deduction, particularly in situations where tax authorities suspect a fraud or an abuse. The analysis will concentrate on two cases: the *Bulves case* (ECHR) and the *Italmoda* case (CJEU). Finally, we will comment on the legal nature of the right to deduct from a fundamental rights perspective.

1 Lejeune/Vermeire, *The CJEU as Guardian of the Charter of Fundamental Rights of the European Union*, in: M. Lang et al. (eds.), *CJEU – Recent Developments in Value Added Tax 2015*, p. 335.

2 Only Art. 1 of the First Additional Protocol, after its first paragraph which states that "every natural or legal person has the right to respect for his goods", recognizes through the second paragraph the "right of the States to put into force the laws which they deem necessary to regulate the use of the goods in a manner which is in the general interest or to ensure the payment of taxes or other contributions or fines".
See the cases: echr, 12 September 2007, *Burden and Burden v. United Kingdom*, Application No. 13378/05; echr, 6 July 2003, *Buffalo s.r.l. v. Italy*, Application No. 38746/97; echr, 16 April 2002, *Dangeville v. France*, Application no. 36677/97, etc.

3 ECHR, 23 February 1995, Gasus Dosier und Fordertechnick GmbH vs. Netherlands, Application No. 15375/89.

4 ECHR, 14 October 2010, ShchoKin v. Ukraine, Applications nos. 23759/03 and 37943/06.

5 ECHR, 16 March 2010, Belmonte v. Italy, Application No. 72638/01.

6 ECHR, 4 November 2013, Imbert de Tremiolles v. France, No.K.M. v Hungary, Application no. 49570/11.

7 ECHR, 1st July 2014, S.A.S. v. France, Application No. 43835/11.

8 ECHR, 5 April 2012, Chambaz v. Switzerland, Application No. 11663/04.

9 ECHR, 4 March 2014, Grande Stevens and Others v. Italy.

2. The right to property as a fundamental taxpayer's right

By its coercive nature, a tax has a potentially restrictive impact on the enjoyment of property rights. In order to prevent any *a priori* conflict between taxation and human rights, Art. 1(1) of the Protocol to the European Convention on Human Rights contains a specific clause in the second paragraph stating that the right to property does not prevent Member States from applying laws aimed at "ensuring the payment of taxes or other contributions or fines". However, the broad wording of this safeguard clause does not provide for absolute protection of public authorities in the exercise of their taxing powers but has to be read in light of the principle of proportionality (functional protection).

The European Court of Human Rights has clarified, in its ruling on a *Hungarian case* concerning the application of a 98% tax on severance payments in the public sector above a certain threshold,[10] that the exercise of the power to tax in accordance with human rights goes beyond the mere respect for the principle of legality but has also a substantive nature.

This safeguard clause does not exist in the EU Charter of Fundamental Rights (or in the Inter-American Convention on Human Rights). However, it is applied in the legal system of the European Union by virtue of the correspondence between Art. 1, I ECHR Protocol and Art. 17 of the EU Charter. In fact, the first paragraph of both articles, in addition to affirming the protection of the right to property within the Charter of Human Rights, recognizes the limitations for reasons of public utility in the cases and in the manner provided by law.

In the absence of a ruling by the Court of Justice of the European Union on the interpretation of Art. 17 of the EU Treaty,[11] it remains to be seen whether it entails the principle of non-confiscation capable of establishing a minimum level of protection of property rights against excessive taxation within the legal system of the European Union.

Such an evolution would also be needed in order to effectively address the well-known issue of international double taxation between Member States. In *Kerckhaert-Morres* and other subsequent cases,[12] the Court of Justice found that double taxation of cross-border dividends was compatible with the fundamental freedoms, since it was a legitimate consequence of the parallel exercise of taxing powers by two Member States.[13] Another example is the famous *Block case*, in which

10 ECHR, 14 May 2013, N.K.M. v. Hungary (Application No. 66529/11); see also ECHR, 4 November 2013, Gáll v. Hungary (Application No. 49570/11).

11 See however CJEU, 5 July 2012, C-558/10, *Bourges-Manoury and Heitz*, EU:C:2012:418, which concerns Art. 13, Protocol on the Privileges and Immunities of the European Communities.

12 CJEU, 14 November 2006, C-514/04, *Kerckhaert-Morre*, EU:C:2006:713.

13 In this context, it would seem useful to recall another known judgment on the subject: CJEU, 20 November 2001, Joined Cases C-414/99 to C-416/99, *Zino Davidoff and Levi Strauss,* EU:C:2001:617.

the simultaneous application of the personal link to the taxation of the heir (in Spain) and the *de cuius* (in Germany), in the absence of a Double Taxation Convention applicable to the subject of inheritance and gift tax, in fact deprived the heir of the right to receive the inherited property.

Consequently, while the European Court of Human Rights recognizes the need to protect the right to property against arbitrary and confiscatory forms of taxation, the European Court of Justice considers that the disparities between the European system and that of a Member State cannot legitimately cause the confiscatory effects of the tax levy. EU law in its current state clearly lacks, despite some references in its caselaw,[14] a unified theory of taxpayer's protection according to ability to pay.[15]

3. The application of the right to property to consumption taxes like VAT

An increasing number of cases are coming before the Court of Justice of the European Union as regards the compatibility of VAT rules with the EU Charter.[16] Just to mention few clear (and particularly significant) examples of the direct relevance of the Charter in specific VAT cases, there are the *Akerberg Fransson* case (C-617/10), which stated that the national rules on tax penalties and criminal proceedings fall within the scope of Art. 50 of the Charter and must comply with the principle "not to be unished twice for the same offence" and the case *WebMind-Licenses*, which established that the use of evidence obtained by the tax authorities without the taxable person's knowledge in the context of ongoing parallel criminal proceedings must not breach Art. 7 of the EU Charter regarding the right to private life.[17] However, no CJEU case thus far has dealt with the application of the right to property in tax matters.

Looking at the ECHR case law, the first question which arises regarding the application of the right to property to indirect tax measures is whether and to what extent there are "possessions" which are to be protected. This question is harder to answer than one might anticipate, even though is often claimed that "every tax is

14 CJEU, 12 June 2018, C-650/16, *Bevola and Jens W. Trock v. Denmark*, ECLI:EU:C:2018:424.

15 On ability to pay and EU law, see F. Alfredo García-Prats, Subjective Ability to Pay: Schumacker and E. Traversa, Objective Ability to Pay: The Gerritse Case, in: W. Haslehner et al. (eds.), *Landmark Decisions of the ECJ in Direct Taxation*, Kluwer, 2015, p. 1 et seq. and p. 21 et seq. See also Vogel, *The justification for taxation: a forgotten question*, in *The American Journal of Jurisprudence*, 1988, p. 19 et seq.

16 The Charter of Fundamental Rights of the European Union became legally binding following its entry into force with the Lisbon Treaty on 1 December 2009, and it has the same legal value as the EU Treaties.

17 See K. Egholm Elgaard, *The impact of the Charter of Fundamental Rights of the European Union on VAT law*, World Journal of VAT/GST Law, 2016, p. 63 et seq.

an infringement of one's property rights", which implies that at some point property has been taken away from the taxpayers, amounting to at least a *prima facie* violation of property rights. It may appear relatively straightforward that the right to property could apply to property taxes as well as direct taxes like income taxes. Nevertheless, its application to consumption taxes may be more controversial, because in that case the economic burden of the tax may be shifted to a person other than the taxpayer and/or incorporated in the price of the goods or services.

While theoretical discussions could also arise concerning the moment the property was taken away by a taxation measure, the ECtHR has taken a very pragmatic approach. The Commission on Human Rights accepted relatively early, that every tax measure forms an interference with the right to property: "*The Commission is of the opinion that any legislation which introduces some sort of fiscal obligation will as such deprive the involved of a possession, namely the amount of money which must be paid*". According to the ECtHR, the taxpayer is protected irrespective of the method by which the tax is levied.[18] According to the Court, the fact that tax was withheld might even provide a further indication that property was in fact acquired by a taxpayer: the very fact that tax was imposed on this income demonstrates that it was regarded as existing revenue by the state, it being inconceivable to impose tax on a non-acquired property or revenue".[19] Given this very broad interpretation, it is not surprising that in the (tax) case law of the ECtHR, the existence of a possession is often assumed or not contested by the respondent state.[20] In accordance with this stance, the Court has also confirmed that the right to tax repayments and even the expectation to be able to deduct input VAT are "possessions" which fall within scope of the right to property.

4. Right to property and denial of the right to deduct granted in the ECHR: the Bulves case

The decision of the European Court of Human Rights (ECtHR) of 22 January 2009 in the case of *Bulves AD vs. Bulgaria*[21] offers an interesting example of the interplay between VAT law and human rights. This case concerned the disallowance under Bulgarian domestic legislation of input VAT where the trader in question was apparently compliant and had no control over its supplier. The case dates from 2000 and so pre-dates Bulgaria's accession to the European Union. Nevertheless, the ECtHR quoted in its judgments the decisions of the European Court

18 ECHR, 4 November 2013, *N.K.M. v. Hungary* (Application No. 66529/11).
19 ECHR, 14 May 2013, *N.K.M. v. Hungary* (Application No. 66529/11).
20 There are, however, some exceptions to this, where the respondent government has contested the existence of possessions. See, e.g., ECtHR, 7 December 2000, *Drosopoulos v. Greece* (Application No. 40442/98); ECtHR, 22 January 2009, *Bulves v. Bulgaria* (Application No. 3991/03).
21 Application number 3991/03.

of Justice in *Optigen Ltd* (and the related cases[22]) and *Axel Kittel* (and the related cases[23]).

Briefly, the applicant company appealed to the ECtHR alleging a violation of Art. 1 of the First Protocol in that it had been denied the peaceful enjoyment of its possessions. The applicant company's case was based on the following contentions: the fact that it had complied fully with the VAT legislation, its absence of control over its supplier and the absence of any reason for it to believe the supplier had not paid over the VAT, and the fact that it should not be denied the deduction of the input VAT on the grounds of failure of the supplier to account properly.

The ECtHR first confirmed that the applicant company had at least a legitimate expectation of being able to deduct its input VAT and this amounted to a "possession" within the meaning of Art. 1 of the First Protocol. The denial of the deduction constituted an interference with the possession and the consequent question was whether this interference could be justified by the government. This required a "fair balance" to be struck between the demands of the general interest of the community and the protection of the company's fundamental rights as well as a reasonable relationship of proportionality between the means employed and the aims pursued. The ECtHR considered that the general interest of the community was in preserving the financial stability of the VAT system and curbing any fraudulent abuse. The Court noted the applicant company paid the VAT twice, once on payment of the original invoice (which was eventually paid over to the state) and once again on the tax assessment. There was, therefore, no negative effect on the state budget. There was also no indication of any involvement by the applicant company in any fraudulent abuse. Accordingly, the ECtHR concluded as follows:

> Considering the timely and full discharge by the applicant company of its VAT reporting obligations, its inability to secure compliance by its supplier with its VAT reporting obligations and the fact that there was no fraud in relation to the VAT system of which the applicant company had knowledge, the Court finds that latter should not have been required to bear the full consequences of its supplier's failure to discharge its VAT reporting obligations in timely fashion, by being refused the right to deduct the input VAT and, as a result, being ordered to pay the VAT a second time, plus interest. The Court considers that this amounted to an excessive individual burden on the applicant company which upset the fair balance that must be maintained between the demands of the general interest of the community and the requirements of the protection of the property rights.

There had accordingly been a violation of Art. 1 of Protocol No. 1. The case is not only relevant because of references to ECJ case law. It is one of a very small number of cases where the ECtHR has been willing to strike down a provision of do-

22 CJEU, 12 January 2006, joined cases C-354/03, C-355/03 and C-484/03, *Optigen Ltd, Fulcrum Electronics Ltd and Bond House Systems Ltd v. Commissioners of Customs & Excise*, EU:C:2005:89.

23 CJEU, 6 July 2006, joined cases C-349/04 and C-404/04, *Axel Kittel vs. Belgian State and Belgian State v. Recolta Recycling SPRL*, EU:C:2005:397.

mestic tax law as infringing Art. 1 of the First Protocol and where it has refused to accept that the national measure was within the wide margin of appreciation enjoined by states in tax matters.

5. Denial of the right to deduct in EU VAT law: Italmoda case

The *Italmoda* case is related to the denial of the right to deduct in VAT fraud situations.[24] It is an interesting case as the CJEU seems to importantly limit the autonomy of the Member States in the application of the VAT rules, but not necessarily in favour of the taxpayer.

The facts were the following. Italmoda was a Dutch company trading shoes.[25] In 1999 and 2000, it was also carrying out supplies of computer equipment. This equipment, that it acquired in the Netherlands and in Germany under a Netherlands VAT identification number, was traded to customers established in Italy. The goods acquired in Germany were supplied directly from Germany to Italy. Italmoda had respected all its VAT requirements regarding the goods acquired in the Netherlands. However, for the goods bought in Germany, it had not declared any intra-Community acquisition (either in the Netherlands or in Germany). Moreover, no intra-Community acquisitions were reported by the Italian customers in Italy.

The Italian authorities decided to collect the VAT due by the Italian clients of Italmoda and denied their right to deduct input VAT. On the other hand, the Dutch tax authorities considered that Italmoda "had knowingly participated in fraudulent activity designed to evade VAT in Italy".[26] Therefore, they refused

> the right to exemption in respect of the intra-Community supplies effected in that Member State, the right to deduct input tax and the right to a refund of the tax paid in respect of the goods originating in Germany, and consequently issued three additional assessments to Italmoda.[27]

The Dutch Court of Appeal however decided that *"there was no justification for departing from the normal system of VAT collection and for refusing to apply the*

24 CJEU, 18 December 2014, joined cases C-131/13, C-163/13 and C-164/13, *Italmoda*, EU:C:2014:2455. The facts regarding the other companies concerned by the other joined cases (C-163/13 – *Turbu*/C-164/13 – *TMP*) will not be analysed, as the requests for a preliminary ruling in these cases have been declared inadmissible.

25 See CJEU, 18 December 2014, joined cases C-131/13, C-163/13 and C-164/13, *Italmoda*, EU:C:2014:2455, paras. 9–14.

26 CJEU, 18 December 2014, joined cases C-131/13, C-163/13 and C-164/13, *Italmoda*, EU:C:2014:2455, para. 11.

27 CJEU, 18 December 2014, joined cases C-131/13, C-163/13 and C-164/13, *Italmoda*, EU:C:2014:2455, para. 11.

exemption or the right to deduct VAT".[28] The case was then brought in front of the Supreme Court of the Netherlands (the Hoge Raad der Nederlanden), which noted that during the period in question (1999–2000), "the application of the exemption or the right of deduction was not subject, under Netherlands law, to the condition that the taxable person must not have deliberately participated in VAT evasion or in a tax avoidance arrangement".[29] This was however the reason invoked by the national authorities to deny the VAT rights concerned. The Dutch Supreme Court therefore decided to refer the matter to the CJEU.[30]

The two questions that are of interest in relation to the present discussion can be summarized as follows:

- On the basis of the EU law, should the national authorities and courts refuse to apply certain VAT rights (in the present case, exemption of intra-Community supply, right to deduct VAT or VAT refund) when VAT evasion has been established and the taxable person concerned knew of or should have known that he was participating therein, even if the national law does not provide any rule to refuse the application of those VAT rights?
- If the answer is positive, should these VAT rights also be refused (i) if the VAT fraud occurred in a Member State other than the Member State in which the goods were dispatched and (ii) if the taxable person concerned has met all the formal conditions imposed by the Member State of dispatch to benefit from the VAT rights and has always provided to that Member State all the required information in respect of the goods, the dispatch and the persons acquiring the goods in the Member State of arrival of the goods?

Regarding the first question, the CJEU first recalled that the prevention and the fight against fraud and abuse is "*an objective recognised and encouraged* " by the VAT Directive, and that a taxable person cannot rely on the application of EU law for fraudulent or abusive purposes.[31] The Court thus considered that these fundamental principles have always to be taken into account when a Member State is evaluating, in application of its procedural autonomy,[32] the possibility of denying

28 CJEU, 18 December 2014, joined cases C-131/13, C-163/13 and C-164/13, *Italmoda*, EU:C:2014:2455, para. 13. The Gerechtshof te Amsterdam took account, in particular, of the fact that the tax evasion had taken place not in the Netherlands, but in Italy, and that Italmoda had, in the Netherlands, satisfied all the formal statutory conditions for the exemption to be applied.

29 CJEU, 18 December 2014, joined cases C-131/13, C-163/13 and C-164/13, *Italmoda*, EU:C:2014:2455, para. 14.

30 CJEU, 18 December 2014, joined cases C-131/13, C-163/13 and C-164/13, *Italmoda*, EU:C:2014:2455, para. 15.

31 CJEU, 18 December 2014, joined cases C-131/13, C-163/13 and C-164/13, *Italmoda*, EU:C:2014:2455, paras. 42–43.

32 The CJEU has indeed clearly stated in the Italmoda case that the denial of VAT rights "*is the responsibility, in general, of the national authorities and courts, irrespective of the VAT right affected by the fraud*". See CJEU, 18 December 2014, joined cases C-131/13, C-163/13 and C-164/13, *Italmoda*, EU:C:2014:2455, para. 46.

the application of VAT rights guaranteed by the VAT Directive. In application of these principles, the CJEU decided that the national authorities and courts must refuse the application of VAT rights

> when they are claimed fraudulently or abusively, irrespective of whether those rights are rights to a deduction, to an exemption or to a VAT refund in respect of intra-Community supplies.[33]

The Court therefore not only recognizes that Member States in the exercise of their procedural autonomy may deny those rights granted by EU law, but goes one step further and states that EU law itself requires the Member States to do so.[34] The CJEU also recalled that this denial is not only applicable

> where tax evasion has been carried out by the taxable person itself but also where a taxable person knew, or should have known, that, by the transaction concerned, it was participating in a transaction involving evasion of VAT carried out by the supplier or by another trader acting upstream or downstream in the supply chain.[35]

The effective participation therefore does not prevail: in the presence of fraudulent elements (active or "conscious" participation), the benefit of VAT rights can be denied. This position was already supported by the CJEU's previous case law.[36]

What is even more interesting is that the Court considered that even if the Dutch national law did not contain any provision that made it possible to deny the right to deduct, EU law – and in particular the EU principle of prohibition of abuse and fraud[37] – required Member States to refuse the benefit of VAT rights.[38] The CJEU also indicated that with respect to these general principles, the denial of rights

> does not amount to imposing an obligation on the individual […] but is merely the consequence of the finding that the objective conditions required [by the VAT Directive] for obtaining the advantage sought […] have, in fact, not been satisfied.[39]

33 CJEU, 18 December 2014, joined cases C-131/13, C-163/13 and C-164/13, *Italmoda*, EU:C:2014:2455, para. 49.

34 CJEU, 13 February 2014, C-18/13, *Maks Pen*, EU:C:2014:69; CJEU, 6 February 2014, C-33/13, *Marcin Jagiełło*, EU:C:2014:184; CJEU, 16 May 2013, C-444/12, *Hardimpex Kft*, EU:C:2013:318.

35 CJEU, 18 December 2014, joined cases C-131/13, C-163/13 and C-164/13, *Italmoda*, EU:C:2014:2455, para. 50.

36 See also CJEU, 6 July 2006, joined cases C-439/04 and C-440/04, *Kittel and Recolta Recycling*, EU:C:2006:446, para. 55; CJEU, 6 December 2012, C-285/11, *Bonik*, EU:C:2012:774, para. 37; CJEU, 13 February 2014, C-18/13, *Maks Pen*, EU:C:2014:69, para. 26; CJEU, 7 December 2010, C-285/09, *R.*, EU:C:2010:742, para. 55; CJEU, 6 September 2012, C-273/11, *Mecsek-Gabona*, EU:C:2012:547, para. 54.

37 The importance of the fight and the prevention of tax fraud and abuse and the impossibility to benefit from EU provisions for fraudulent or abusive ends.

38 CJEU, 18 December 2014, joined cases C-131/13, C-163/13 and C-164/13, *Italmoda*, EU:C:2014:2455, paras. 51–56.

39 CJEU, 18 December 2014, joined cases C-131/13, C-163/13 and C-164/13, *Italmoda*, EU:C:2014:2455, para. 57.

> Therefore, the CJEU decided that the national authorities and courts have to deny a taxable person the benefit of the VAT rights concerned even in the absence of provisions of national law providing for such refusal, if it is established, in the light of objective factors, that that taxable person knew, or should have known, that, by the transaction relied on as a basis for the right concerned, it was participating in VAT evasion committed in the context of a chain of supplies.[40]

The CJEU had then to decide if this denial of VAT rights in the case of a fraudulent situation is dependent on certain circumstances; in the *Italmoda* case, on the fact that

> first, the VAT evasion was committed in a Member State other than that in which the benefit of those various rights has been sought and, secondly, the taxable person concerned has, in the latter Member State, complied with the formal requirements laid down by national legislation for the purpose of benefiting from those rights.[41]

In line with previous-case-law, in particular the *R.* case[42], the Court considered that there was no objective reason to conclude that the treatment should be different in the case of VAT evasion concerning different Member States or because formal requirements provided by national law to benefit from the VAT rights had been respected. The Court again reaffirmed the prevalence of the general EU principle of prohibition of fraud and abuse in that respect.[43] Therefore, the CJEU decided to uphold the refusal by national authorities and courts to grant a taxable person the VAT rights in question

> notwithstanding the fact that the evasion was carried out in a Member State other than that in which the benefit of those rights has been sought and that taxable person has, in the latter Member State, complied with the formal requirements laid down by national legislation for the purpose of benefiting from those rights.[44]

40 CJEU, 18 December 2014, joined cases C-131/13, C-163/13 and C-164/13, *Italmoda*, EU:C:2014:2455, para. 62.

41 CJEU, 18 December 2014, joined cases C-131/13, C-163/13 and C-164/13, *Italmoda*, EU:C:2014:2455, para. 63.

42 As in case CJEU, 7 December 2010, C-285/09, *R.* v. *Generalbundesanwalt beim Bundesgerichtshof, and Finanzamt Karlsruhe-Durlach*, ECLI:EU:C:2010:742, where the Court provides that: "*In circumstances such as those at issue in the main proceedings, in which an intra-Community supply of goods has actually taken place, but when, at the time of that supply, the supplier concealed the identity of the true purchaser in order to enable the latter to evade payment of value added tax, the Member State of departure of the intra-Community supply may, pursuant to its powers under the first part of the sentence in Article 28c(A) of Sixth Council Directive 77/388/EEC of 17 May 1977 on the harmonisation of the laws of the Member States relating to turnover taxes – Common system of value added tax: uniform basis of assessment, as amended by Council Directive 2000/65/EC of 17 October 2000, refuse to allow an exemption in respect of that transaction*".

43 CJEU, 18 December 2014, joined cases C-131/13, C-163/13 and C-164/13, *Italmoda*, EU:C:2014:2455, paras. 64–68.

44 CJEU, 18 December 2014, joined cases C-131/13, C-163/13 and C-164/13, *Italmoda*, EU:C:2014:2455, para. 69.

The *Italmoda* case – as well as other cases on the abuse of rights in VAT[45]– clearly shows that the right to deduct is not (only) a taxpayer's right but also has a systemic function within the VAT system, particularly in the fight against behaviours leading to VAT revenue losses.

6. Concluding remarks on the nature of the right to deduct as an individual right

In the area of VAT, the "right" to deduct is an inherent part of the VAT system, which also establishes a general liability for economic actors involved in economic transactions. It is subject to conditions, which partly reflects the objectives of the VAT system, i.e. to collect revenues for public authorities. Of course, the system also has more specific objectives such as neutrality, which is however a principle with many exceptions.

Looking at other areas of administrative law, one might wonder whether monetary claims against the state could be considered as a right (to property) enjoying a constitutional status. If this were the case, it would imply a kind of hierarchy (and a different interpretation) between rules contained in the VAT Directive: the rules creating or extending tax liability to be constructed narrowly and the rules limiting tax lability to be construed broadly. One might also question whether the Directive allows such a distinction, since all the rules contained in it have been adopted according to the same procedure.

Moreover, there is a need to balance the *Bulves* case law with the more recent *Taricco* I and II case law dealing with VAT fraud and the protection of the financial interests of the European Union/Member States.[46] The right to deduction and the principle of neutrality of VAT, indeed, have to be balanced with the prevention of tax abuse and fraud, in the light of the principle of proportionality. It is always necessary to verify whether a taxpayer has or has not consciously participated in the fraud. It appears in this context quite bizarre to make the effectiveness of a property right dependent upon the intention of the taxpayer. Therefore, it should be determined whether the denial of the right to deduct must be considered as a sanction (the compatibility of which with human rights law should be assessed as such) or as a deprivation of property.

In conclusion, in order to decide whether it is worth "importing" the ECHR case law on the right to property as regards the right to deduct in EU VAT, it requires

45 See CJEU, 22 November 2017, C-251/16, *Cussens v. Brossman*, ECLI:EU:C:2017:881 and CJEU, 21 February 2006, C-255/02, *Halifax plc, Leeds Permanent Development Services Ltd and County Wide Property Investments Ltd v. Commissioners of Customs & Excise*, EU:C:2006:121, and the case law quoted.

46 CJEU, 18 December 2014, joined cases C-131/13, C-163/13 and C-164/13, *Italmoda*, EU:C:2014:2455, para. 69.

to assess whether that could add to the already existing guarantees offered to VAT taxable persons under the EU VAT Directive as interpreted by the Court of Justice. Considering that the proportionality principle constitutes what is already a rather effective tool in the hands of the courts to limit excesses by tax authorities, it remains to be seen whether the ECHR case law could add anything. Indeed, it is likely that in a situation like *Bulves* case, the CJEU would have similarly ruled in favour of the taxpayer, but by "normal" application of the rules on the right to deduct, without having to refer to the EU Charter.

Equality under State aid rules and VAT

Joachim Englisch

1. Introduction

In matters relating to VAT, it is the fundamental principle of fiscal neutrality that is generally perceived to reflect the principle of equal treatment.[1] However, other equality standards of Union law also have an impact on VAT design, and constitutional scrutiny of European VAT legislation. Some case law exists on the need to respect the general principle of equality, now enshrined in Art. 20 EUCh and previously conceived by the CJEU as a general principle of Union law, also in the field of VAT.[2] Furthermore, the Court has occasionally had to rule on the compatibility of EU VAT legislation with the free movement guarantees of the TFEU, and the free movement of goods and services, in particular.[3] What is often overlooked is the fact that under certain conditions, preferential or advantageous VAT regimes can also be subject to an equal treatment test under the prohibition on fiscal State aid, laid down in Art. 107 (1) of the TFEU. Admittedly, State aid implications of beneficial tax law provisions were generally widely ignored until two decades ago, when the Commission published its "Notice on the application of the State aid rules to measures relating to direct business taxation".[4] Since then, however, the awareness of national legislatures and courts, and not the least of the Commission itself, of the potential inherent in the prohibition of fiscal State aid to tackle discriminatory tax treatment has increased significantly. This development has culminated in the wake of the recent Commission proceedings in the so-called "tax ruling cases".[5] So far, the Commission as the designated guardian of the State aid provisions, and the Court as their ultimate interpreter, have only rarely dealt with VAT cases.[6] But the increased awareness of all stakeholders likely implies that advantageous VAT regimes, too, will progressively come under more comprehensive State aid scrutiny.

Against this backdrop, this article analyses the impact of the equality dimension inherent in Art. 107 (1) of the TFEU in the field of VAT, and its interaction with other Union law equal treatment guarantees. To lay the foundation for this anal-

1 See, e.g., CJEU, 10 April 2008, C-309/06, *Marks & Spencer*, EU:C:2008:211, para. 49; 29 October 2009, C-174/08, *NCC Construction Danmark*, EU:C:2009:669, para. 41; 10 November 2011, C-259/10 a.o., *The Rank Group*, EU:C:2011:719, para. 61; 31 January 2013, C-643/11, *LVK-56*, EU:C:2013:55, para. 55; 14 June 2017, C-38/16, *Compass Contract Services*, EU:C:2017:454, para. 21; 16 November 2017, C-308/16, *Kozuba Premium Selection*, EU:C:2017:869, para. 43.

2 See, e.g., CJEU, 7 March 2017, C-90/15, *RPO*, EU:C:2017:174, paras. 37 et seq.; 14 July 2017, C-38/16, *Compass Contract Services*, EU:C:2017:454, para. 24.

3 See, e.g., CJEU, 10 July 1984, C-42/83, *Dansk Denkavit*, EU:C:1984:254, paras. 22 et seq. (regarding what is now Art. 110 of the TFEU); 26 October 2010, C-97/09, *Schmelz*, EU:C:2010:632 (regarding what is now Art. 56 of the TFEU).

4 Commission Notice on the application of the State aid rules to measures relating to direct business taxation, OJ C 384, 10 December 1998, p. 3 et seq.

5 See http://ec.europa.eu/competition/state_aid/tax_rulings/index_en.html, accessed on 5 February 2019.

6 Regarding the Court, see, e.g., CJEU, 3 March 2005, C-172/03, *Heiser,* EU:C:2005:130; 23 April 2009, C-460/07, *Puffer,* EU:C:2009:254.

ysis, there will be an initial discussion on the extent to which a tax such as VAT that is harmonized through acts of Union legislation can still be subject to *State* aid control. This mostly builds on an earlier contribution to research on this subject[7], but takes into account recent developments in the CJEU case law. Subsequently, the article builds on this overview and offers a critical assessment of the Court's general understanding of the non-discrimination standard inherent in the prohibition of selective and distortive fiscal aid. Finally, the focus will be on the most relevant implications of the Court's approach and of possible alternative approaches for preferential VAT regimes. The article concludes with a résumé of the core findings.

2. VAT: within the ambit of State aid rules?

Pursuant to Art. 107 (1) of the TFEU, "save as otherwise provided in the Treaties, any aid granted by a Member State or through State resources in any form whatsoever which distorts or threatens to distort competition by favoring certain undertakings or the production of certain goods shall, in so far as it affects trade between Member States, be incompatible with the internal market."

2.1. Fiscal aid covered

According to settled case law, the concept of aid must be construed in a broad sense. It also covers State measures which, in various forms, mitigate the charges which are normally included in the budget of an undertaking and which thus, without being subsidies in the strict sense of the word, are similar in character and have the same effect.[8] Consequently, a measure by which the public authorities grant certain undertakings a special tax treatment, which places the recipients in a more favorable financial position than other taxpayers, can amount to State aid within the meaning of Art. 107 (1) of the TFEU.[9] Any relief regarding the statutory tax burden or the tax collection is furthermore granted "through State resources".[10] In principle, and provided that all other constituent elements of the concept of selective State aid are met, VAT concessions and other forms of preferential treatment of certain businesses for VAT purposes therefore come within the substantive scope of Art. 107 (1) of the TFEU.

7 J. Englisch, *State aid and indirect taxation*, in: A. Rust/C. Micheau (eds.), *State Aid and Tax Law*, p. 69.

8 See, e.g., CJEU, 8 November 2001, C-143/99, *Adria-Wien Pipeline and Wietersdorfer & Peggauer Zementwerke*, EU:C:2001:598, para. 38; 8 September 2011, Joined Cases C-78/08 to C-80/08, *Paint Graphos and Others*, EU:C:2011:732, para. 45.

9 See, e.g., CJEU, 15 November 2011, Joined Cases C-106/09 P and C-107/09 P, *Commission and Spain v Government of Gibraltar and United Kingdom*, EU:C:2011:732, para. 72.

10 See, e.g., CJEU, 19 September 2000, C-156/98, *Germany/Commission*, EU:C:2000:467, para. 25.

2.2. Taxable persons as potential beneficiaries

Any taxable person as defined in Art. 9 (1) of the VAT Directive can furthermore fall within the personal scope of Art. 107 (1) of the TFEU.

Pursuant to Art. 9 (1) of the VAT Directive, the notion of "taxable person" shall mean any person who, independently, carries out an economic activity, whatever the purpose or results of that activity. The Court has clarified that for the purposes of VAT, economic activities consist in the supply of goods or services for consideration.[11] Whether the supplier is a regular economic agent or a non-profit organization has no bearing on its taxable person status.[12]

In a similar vein, the concept of "undertaking" within the meaning of Art. 107 (1) of the TFEU covers any entity engaged in an economic activity.[13] Furthermore, any activity consisting in offering goods or services on a given market for consideration has been held by the CJEU to constitute such an economic activity.[14] Just as in the context of Art. 9 (1) of the VAT Directive, it is irrelevant whether the supplies are made on a not-for-profit basis.[15]

2.3. Does it matter who is the intended ultimate beneficiary?

VAT is conceived as an indirect tax on consumption expenditure. It is levied from businesses that qualify as taxable persons but is intended to be borne by final consumers through a corresponding increase in the price of the goods or services supplied by the business. Similar to any other indirect tax, a tax concession or relief resulting from a reduction or elimination of the regular tax burden could therefore be targeting either one of two possible addressees: the taxable person who acts as tax collector for the government, or the recipients of the supply, in particular consumers who are the designated final (or actual) taxpayers. Regarding VAT in particular, certain reduced or zero rates and exemptions are granted in order to alleviate the tax burden for final consumers, and are thus intended to benefit the latter rather than the supplier who is liable to pay the VAT to the tax authorities.[16] This raises the question whether the latter categories of tax relief, too, can be regarded as potential fiscal State aid within the meaning of Art. 107 (1) of the TFEU.

11 See, e.g., CJEU, 25 July 2018, C-128/16 P, *Commission/Spain*, EU:C:2018:591, para. 34.

12 See, e.g., CJEU, 20 June 2013, C-219/12, *Fuchs*, EU:C:2013:413, para. 25.

13 See, e.g., CJEU, 16 March 2004, Joined Cases C-264/01, C-306/01, C-354/01 and C-355/01, *AOK Bundesverband and Others*, EU:C:2004:150, para. 46.

14 CJEU, 10 January 2006, C-222/04, *Cassa di Risparmio di Firenze,* EU:C:2006:8, para. 108; 27 June 2017, C-74/16, *Congregación de Escuelas Pías Provincia Betania,* EU:C:2017:496, para. 47.

15 CJEU, 27 June 2017, C-74/16, *Congregación de Escuelas Pías Provincia Betania*, EU:C:2017:496, para. 46.

16 For a more extensive discussion of the criteria that should be relied on in order to determine, in the context of an indirect tax, whether a tax relief measure presumably benefits the consumer as the final taxpayer, or the business as the taxable person, see J. Englisch, *EU State Aid Rules Applied to Indirect Tax Measures*, EC Tax Review 2013, p. 9.

Tax expenditure regimes will be qualified as forbidden aid only if they benefit "undertakings". If one were to presume that the tax concession under scrutiny is passed on to the customers of the business rather than conferring any benefits upon the taxable person itself, it could be argued that for the purposes of Art. 107 (1) of the TFEU, the advantage constitutes aid only to the extent that these customers are also undertakings. Furthermore, in the specific context of a value added tax, the tax concession would even then only constitute an advantage for the business customer if the latter were not entitled to an input VAT credit.

To the author's knowledge, there is only one judgment of the CJEU that has explicitly addressed the issue: In the case *Heiser*[17], the Court had to deal with a transitional regime according to which certain taxable persons did not need to adjust input VAT deductions for goods and services that were initially acquired for the purpose of taxed transactions but that were ultimately used in order to carry out exempt supplies.[18] The Court, in examining the compatibility of said regime with Art. 107 (1) of the TFEU, ruled as follows:

> … with regard to the effects of a measure such as that at issue in the main proceedings, it must be observed that, in law, [taxable persons] are the only beneficiaries. There is no indication in the case-file put before the Court by the referring court that the benefit of that measure was systematically passed on by them to [the recipients of the supply] so that the advantage was, in the end, cancelled out for [the taxable persons].[19]

It is not clear whether the Court thereby sought to establish a general rule pursuant to which VAT exemptions or other tax relief measures must be deemed to benefit the taxable person, unless evidence is put forward to the contrary.[20]

More recently, however, the CJEU has indicated that as a general rule, it considers the notion of "economic passing on" to be irrelevant for determining the recipient of an advantage for the purposes of Art. 107 (1) of the TFEU.[21] Consequently, the Court has held that "*the question whether, from a technical point of view, [a tax] is to be classified as a direct or indirect tax is irrelevant*".[22] To explain its position, which deviated from what the General Court had ruled at first instance[23], the CJEU distinguished between "the advantage procured by the aid" and an "economic ben-

17 CJEU, 3 March 2005, C-172/03, *Heiser,* EU:C:2005:130.

18 As a general rule, under the harmonized EU system of VAT an input VAT credit may be claimed only to the extent that input goods and services are used for the purposes of taxed transactions, pursuant to Art. 168 of the VAT Directive 2006/112/EC.

19 CJEU, 3 March 2005, C-172/03, *Heiser*, EU:C:2005:130, para. 47.

20 For an extensive discussion of the judgment, see J. Englisch, *State aid and indirect taxation*, in: A. Rust/C. Micheau (eds.), *State Aid and Tax Law*, p. 69.

21 CJEU, 21 December 2016, Joined Cases C-164/15 P and C-165/15 P, *Aer Lingus and Ryanair* EU:C:2016:990, para. 99.

22 CJEU, 21 December 2016, Joined Cases C-164/15 P and C-165/15 P, *Aer Lingus and Ryanair*, EU:C:2016:990, para. 98.

23 See EGC, 5 February 2015, T-473/12, *Aer Lingus*, EU:T:2015:78, para. 105; 5 February 2015, T-500/12, *Ryanair v Commission*, EU:T:2015:73, para. 136.

efit" that the advantage confers. According to the CJEU, which relied on a legalistic understanding of "aid", only the "advantage" that consists in a reduction of the tax liability should be relevant, regardless of who ultimately benefits economically from the reduction.[24] It is therefore the person whose tax liability is reduced who should always be regarded as the recipient of aid. In the context of VAT, this is the taxable person as defined in Art. 9 (1) of the VAT Directive.

Admittedly, the CJEU made these statements in the context of litigation concerning the amount of fiscal aid to be recovered from an undertaking, when a tax advantage that the taxable person could claim was intended by the legislature to be passed on to the customers of this business: the full nominal amount of the tax relief, or only the (indirect) economic benefit that the undertaking could derive from such a benefit, e.g. a greater market share or increased profitability. But the wording of the judgment made it quite clear that the Court would apply its legalistic approach also to the initial stage of determining whether the undertaking – rather than its customers – can be regarded as recipient of the aid.

However, it is respectfully submitted that the Court's view implies potentially disproportionate consequences for businesses, and is not justified by the rationale of State aid control. The CJEU should therefore not have endorsed the unconvincing conclusions of the Advocate General who advised it on the case. While it is true that the economic incidence and other economic repercussions of a tax relief do not normally play a role in determining whether and to what extent an undertaking has received aid[25], this must arguably be different if the legislature intends the benefit to be passed on to a third party, and if the legal design of the measure and of the tax into which it is embedded moreover supports such a conception.[26] The Court itself has in fact assumed this to be the case in some decisions relating to indirect fiscal aid accorded to certain undertakings through tax relief measures available to other taxpayers.[27] The contrary approach of the Court in the field of indirect taxes could only be acceptable if a generous protection of legitimate expectations were accorded to taxable persons, which, however, is currently not the case.[28]

24 CJEU, 21 December 2016, Joined Cases C-164/15 P and C-165/15 P, *Aer Lingus and Ryanair*, EU:C:2016:990, para. 92.

25 See Opinion of Advocate General Mengozzi, 5 July 2016, Joined Cases C-164/15 P and C-165/15 P, *Aer Lingus and Ryanair*, EU:C:2016:515, paras. 62 et seq.

26 A fortiori, the recovery of unlawful aid should not be (ab-)used as a deterrent for undertakings to discourage them from becoming complicit in an aid scheme that has not been notified to the Commission in compliance with the procedure laid down by Art. 108 (3) of the TFEU; see, however, Opinion of Advocate General Mengozzi, 5 July 2016, Joined Cases C-164/15 P and C-165/15 P, *Aer Lingus and Ryanair*, EU:C:2016:515, para. 65. Businesses in competitive markets will be forced to pass (at least some of) the tax relief on to their customers.

27 See, e.g., CJEU, 19 September 2000, C-156/98, *Germany/Commission*, EU:C:2000:467, paras. 22 et seq.; 13 June 2002, C-382/99, *Netherlands/Commission*, EU:C:2002:363, paras. 11, 38 and 60–66.

28 The CJEU has formulated strict standards for the protection of legitimate expectations vis-à-vis the recovery of illegal aid; see, e.g., CJEU, 20 September 1990, C-5/89, *Commission/Germany*, EU:C:1990:320, para. 14; 15 December 2005, C-148/04, *Unicredito Italiano*, EU:C:2005:774, paras. 104 et seq.